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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

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EXTERNAL SOURCES OF FINANCING

(Note by the secretariat)

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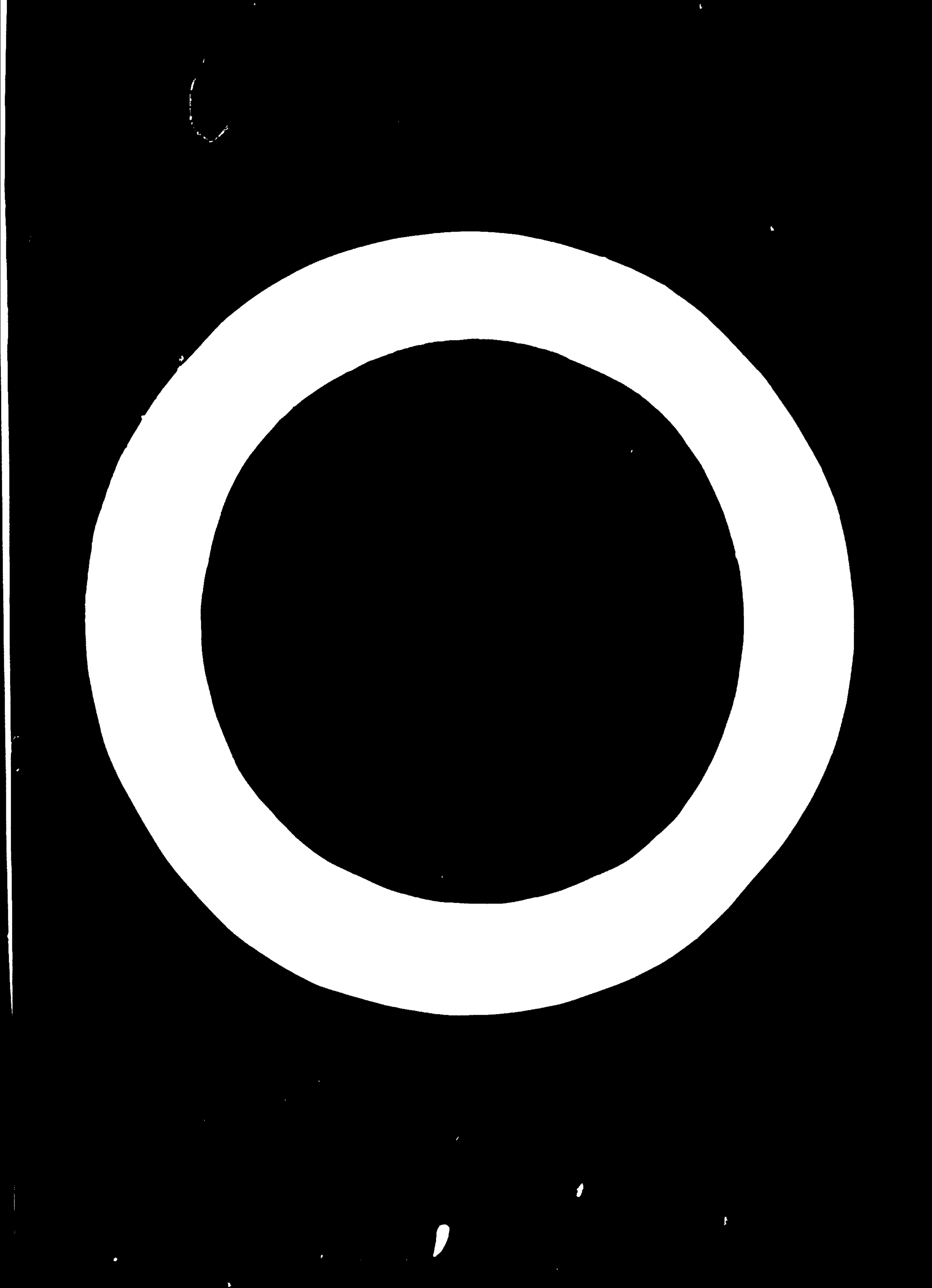

EXTERNAL SOURCES OF FINANCING

1. The primary purpose of this paper is to set forth as a basis for discussion some major issues of policy which arise in the external financing of industrial development in Africa. No attempt is made to describe in detail the sources of external financing available nor to make quantitative estimates either of what is being provided or what is required.

2. The main sources of external funds are as follows:

- Private foreign direct investment;
- Loans from international and inter-regional agencies or from government finance institutions;
- Government to government financing;
- Suppliers' credits or export credits.

3. Private foreign direct investment to industry has not so far been a major source of finance particularly in Africa. United States private investment in Latin America and United Kingdom investment in the Commonwealth, particularly India, is important; there is also, for example, some French and Belgian private investment in industry in their former African territories, although on a small scale. Part of the reason often given for limited foreign private investment in industry is what is known as the investment climate, real or imaginary, and steps being taken to provide greater incentives are referred to later in this paper. A more important point is the viability of projects, this in turn being due in part to the limited size of markets, insufficiency of real purchasing power and inexperienced management. African governments are therefore paying increasing attention to the promotion of multinational and sub-regional co-operation and tackling industrial development through the grouping and sharing of industries.

4. In the international group the principal organisation is the World Bank group consisting of the Bank itself, making hard loans either directly to industry or indirectly through development finance corporations; soft loans through its International Development Association; and

loans to private industry through the International Finance Corporation. The last agency has hitherto been on a small scale with a capital of 100 million dollars, but arrangements have now been made to multiply the resources available three or four times through loans from the Bank itself. In Africa much of the Bank's investment has been in infrastructure and increasing attention is being paid to agriculture. Little has so far been done in Industry. The IFC can lend only to private industry; the Bank and IDA have hitherto in practice confined themselves to the private sector, whether enterprises or development banks. However, within the African context consideration is now being given to a possible adjustment of this policy. In Latin America the lending operations of the inter-American Development Bank in industry are becoming significant and it may be expected that the recently created African Development Bank will also take an interest in industrial projects. The European Investment Bank is concerned only with countries belonging to the European Common Market and their associates. So far its operations in industry in the developing world appear to have been confined to the less developed parts of Europe.

5. Within this group of institutions the Export/Import Bank in Washington should be considered. This has made relatively few development loans in which industries are included and little in Africa. However, each year it extends a large number of export credits for capital goods mainly at the request of United States suppliers or Banks.

6. The Commonwealth Development Corporation makes loans within the commonwealth, but on a small scale.

7. Government to government financing has become important in Africa in recent years but data are not available as to how much has found its way into industry. Financing of industrial projects is known to have accounted for a substantial part of German financial aid but the share of industrial financing in French aid has been small. The centrally planned economies have concentrated the bulk of their aid on industrial projects as part of their avowed policy to promote industrialization in the developing countries, but so far the share of their aid going to Africa has been relatively small.

8. Although figures are not available, suppliers' credits play an important part in industrial financing. However, they add to the debt burden of the receiving countries which are obliged to repay short-or medium-term credits rather than incur long-term debts. In addition it is not infrequently found that the prices charged for equipment financed in this way are high.

9. In recent discussions there have been a number of estimates of the so-called trade gap of the developing countries[1/] which has to be closed either by opening wider the doors of the developed world to the exports of the less developed, by increased foreign aid, or both. Detailed and reliable estimates for Africa are not available and the argument is normally conducted in global terms. Although Africa's requirements of foreign financial aid for industrial development are undoubtedly very large there may be some danger for Africa if the argument is left on this rather general and global basis. Furthermore, there is a risk that the many other steps that have to be taken may be obscured or even lost sight of.

10. The first point to be made is that there is a need for and also much scope for an increase in domestic savings. In particular, the marginal rate saving can rise rapidly as development proceeds and incomes grow. This is not only necessary in itself but is also a pre-requisite to increased foreign aid. Consideration of the problems of increased domestic financing of industrial development is however outside the scope of this paper.[2/]

11. Nevertheless domestic saving alone cannot hope to finance the industrial development programmes now being envisaged. Furthermore, it is particularly in the early stages that foreign aid is most needed.

1/ See, for example, United Nations World Economic Survey 1962, Part I: Developing countries and World Trade, New York, 1963.

2/ 'Invested Finance in Five African Countries', R. Meagher.

A number of desirable reforms in the provision of foreign aid are now being discussed and most of them apply with special force to Africa. It is becoming increasingly clear that aid is more useful on a national development plan basis, rather than a project basis, even though where countries are small and with no proper development plans it would be unrealistic to expect aid on a project basis to be discontinued at an early date. In so far as project aid is bound to continue this should be calculated on the basis of total cost including domestic costs less the possible domestic contribution, which naturally varies from country to country. Although from the point of view of the donor with balance of payments difficulties tied aid is understandable, it is desirable that every effort should be made to move away from it on an agreed basis among the donor countries as quickly as possible. The growing burden of debt repayment demonstrates the importance of lengthening grace periods and of the loan itself together with lower rates of interest. In many African countries grants are preferable to loans. It is largely current practice that aid should be concentrated primarily on countries with the most absorptive capacity. There is much to be said for giving more weight to the opposite policy and concentrating a much larger slice of soft loans and grants on the poorest countries, coupled with a determined effort to increase absorptive capacity.

12. It has been clearly demonstrated that much industrial development in Africa requires the grouping of countries and the sharing out of large scale projects. This can be facilitated by appropriate measures on the part of the aid-giving and aid receiving countries. In this context arrangements along the lines of the Aid to India Consortium may be envisaged. The African Council for Economic Co-operation proposed by ECA and now under consideration by African Governments is potentially of great importance.

13. The need for more domestic saving, for more foreign aid and for reforms in the process of aid giving is clear. Yet it is of still greater importance to examine why more of the foreign funds already available or potentially available are not flowing into African industrial development. One problem already referred to is adequate incentives.

There have been recent improvements towards this end, e.g. the World Bank's Convention for the settlement of Investment Disputes, the scheme proposed by the OECD for a multilateral guarantee of foreign investment against non-commercial risks, and the World Bank scheme being worked out for compensatory development finance. Investment guarantees and investment codes can also be useful. Most African countries have prepared such schemes.1/ There is a good case for harmonising these arrangements, preferably sub-regionally, partly to ensure proper arrangements for the foreign investor and partly to avoid unnecessary competition in extending facilities among African countries.

14. Yet of even greater importance is the need for the finding of sound bankable projects, partly by the ruthless elimination of ventures of a prestige character, partly by the grouping of neighbouring countries to provide large enough markets, and most of all through proper and systematic project preparation.2/

1/ See Investment Laws and Regulations in Africa, UN Sales No: 65.II.K.3, United Nations, New York, 1965.

2/ 'Industrial Programming and Project Evaluation' (Summary of Proceedings of the Inter-Regional Seminar, Prague October 1965)

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